United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

75-7031 ORIGINAL

75-7038 31 B P/S

To be argued by
BERNARD MINDICH

United States Court of Appeals

FOR THE SECOND CIRCUIT

Docket Nos. 75—7038, 75—7055, 75—7057

HOWARD BERSCH,
Plaintiff-Appellee,

against

ARTHUR ANDERSEN & CO., I.O.S., LTD., and BERNARD CORNFELD,
Defendants-Appellants,

and

DREXEL FIRESTONE, INC., DREXEL HARRIMAN RIPLEY, BANQUE ROTHSCHILD, HILL SAMUEL & CO., LIMITED, GUINESS MAHON & CO., LIMITED, PIERSON, HELDRING & PIERSON, SMITH, BARNEY & CO., INCORPORATED, J. H. CRANG & CO., INVESTORS OVERSEAS BANK LIMITED,
Defendants.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF OF DEFENDANT-APPELLANT I.O.S., LTD. (Now in Liquidation)

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REPLY BRIEF OF DEFENDANT-APPELLANT I.O.S., LTD. (Now in Liquidation)

Preliminary Statement

This brief is submitted on behalf of defendant-appellant I.O.S. Ltd. ("IOS"), as now in liquidation pursuant the Winding-Up Act of Canada, in reply to the "Brief of the Plaintiff-Appellee" filed herein in opposition to the instant appeal.

As will hereinafter be demonstrated in detail, the plaintiff-appellee has completely failed to rebut the extensive showing made in the original briefs of IOS and its co-appellants that the District court's decision is totally unsupported by the controlling decisions of this Court in the Leasco and Schoenbaum cases and is inconsistent with controlling decisions of the United States Supreme Court and other courts which establish that whatever may be the rights of an American plaintiff to sue with respect to the matters alleged in the Complaint herein, there is no proper basis for jurisdiction over the claims of foreign purchasers who bought the stock of IOS, a foreign issuer, in foreign transactions.

FACTUAL MATTERS RELEVANT TO ALL POINTS

Before turning to the legal deficiencies of plaintiff's answering brief, it is necessary to call to the Court's attention several extremely serious and prejudicial misstatements of fact made in said brief -- misstatements which go to the very heart of plaintiff's position in opposition to this appeal.

A. Erroneous Claims Re American Investors

In the defendant's original briefs, it was noted and emphasized that the stock offerings at issue in this matter were

basically foreign transactions involving 11,000,000 shares of the stock of a foreign issuer (IOS) with sales being made to between 40,000 and 100,000 purchasers. More than 98.5% of said purchasers were non-United States citizens whose purchases were made in foreign countries (IOS Main Brief, pp. 16-22). It was further shown that the remaining small percentage of purchasers, totalling approximately 386, were non-residents of the United States, except for between 11 and 37 persons who appeared to be American residents, all of whom were employed by IOS or otherwise associated with IOS, and all of whose purchases were consummated outside the United States (IOS Main Brief, pp. 20-21).

On this appeal, plaintiff has tried to surmount the difficulty of justifying the District Court's assumption of jurisdiction over such clearly foreign transactions by making misstatements of fact which, if they went uncorrected, would leave the impression that sales to Americans had actually been substantial, contrary to the facts stated by the defendants in their briefs.

Thus, plaintiff opens his brief with a series of factual assertions, the most important one being the claim that, "386 Americans purchased 1,507,578 shares of IOS stock" and that "thus, Americans purchased over 13.7% of the shares sold at the Public offering" (Plaintiff-Appellee's Brief [herein-

after cited as "PB"], p. 4; see also id., p.7), (emphasis added). This statement, however, represents a gross mathematical error and distortion of the record. Indeed the fact is that American members of plaintiff's purported class actually purchased no more than 1.3% of the 11,000,000 shares sold in the three offerings. And American residents in said class purchased no more than .013% of such shares.

Thus, if one merely turns to the pages of the appendices cited in support of plaintiff's assertions (i.e., 227A-228A; 229A-232A; and 131PA-160PA),* and does the necessary arithmetic, it will be seen first that the true number of shares purchased by the persons listed there is only 844,683 -- not the 1,507,578 shares claimed by plaintiff. (Annexed hereto as Exhibit "A" is an adding machine tape totalling all the shares listed on the cited pages.)

But more importantly, it is also immediately seen that even the 844,683 share figure is not an accurate figure for "purchases by Americans", for a further examination of the documents relied upon by plaintiff (particularly 160PA) demonstrates that fully 662,895 shares of the 844,683 (i.e., 78% of the correct total) were actually recorded as being purchased by the "IOS Foundation of Delaware", whose address is given as "c/o I.O.S., Ltd.,

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* References bearing the suffix letter "A" are to the Appellants' Appendix; references bearing the suffix letters "PA" are to the Plaintiff-Appellee's Appendix.

119 Rue de Lausanne; Geneva, Switzerland". The IOS Foundation, however, was a direct affiliate of and controlled by defendant IOS -- and although it was technically an American corporation it is misleading in the extreme to suggest, as plaintiff has, that purchases by a company under the control of the issuer, a defendant in this action, can be counted as purchases by an American investor. At a bare minimum, plaintiff was obliged to state that one of his "Americans" was an IOS-controlled corporation, and that it had bought 78% of the shares in question. This Court could then accurately decide on its own the significance of plaintiff's presentation.*

The result of the foreoing is that, at the very most, only 181,788 IOS shares -- out of a total of 11,000,000 sold in the three offerings in issue -- were bought by American purchasers -- not the 1,507,578 claimed by plaintiff. Additionally it should be noted that all of such shares were purchased by IOS insiders and that of that number, even plaintiff does not contend that American residents purchased more than 51,548 shares

* Moreover, even if plaintiff is relying on the technicality that the IOS Foundation was an American corporation, that fact does not excuse his misstatement. For it appears even from the record introduced by plaintiff in this case that the IOS Foundation held the shares only very briefly, and that they were almost immediately transferred to the I.O.S. Stock Option Plan, Ltd., which was a Bahamas corporation. This information is set forth at pages 314-15 of the book "Do You Sincerely Want to Be Rich?", pages 215-16PA of Plaintiff's Appendix herein.

(PB, p. 4). However, even those totals are misleadingly high, since 39,400 shares were bought by directors of IOS -- i.e., in substance defendants in this action -- who cannot fairly be considered part of plaintiff's alleged class.* Moreover, directors' shares make up most of the shares bought by resident Americans (i.e., 34,400 of 51,548). If one subtracts the directors' shares, one reaches the ultimate figure of 142,388 shares -- not 1,507,578 -- as having been bought by Americans (mostly non-residents) -- and a maximum of only 17,148 shares as having been bought by American residents. Otherwise stated, plaintiff has claimed a figure more than 10 times as great as can fairly be sustained for shares purchased by Americans.

Thus, far from it being true that "Americans purchased over 13.7% of the total shares," as has been so boldly asserted by plaintiff, the truth is that an accurate computation yields a figure of less than 1.3%. And, even more to the point, it appears that fewer than .013% of the 11,000,000 shares were purchased by resident Americans.**

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* Plaintiff has yet to come up with a single member of the general American investing public who purchased a single share in any of the three offerings.

** It should also be noted that plaintiff's completely erroneous calculation of the number of shares purchased by Americans is apparently further employed by him as the basis for a self-serving statement implying that his alleged class is not of an unmanageable size (PB, p. 5).

B. Other Factual Errors

Plaintiff's misstatements of fact are by no means confined to the opening section of the brief where he purports to "correct" defendants' alleged "errors" and "distortions". Thus, for example in his "description" of IOS, plaintiff asserts that "IOS maintained an office on Madison Avenue in New York" (PB, p. 10). However, examination of plaintiff's record reference* indicates that the office was not maintained by IOS, but rather by the plaintiff's own former employer, Saja Associates, Ltd. Indeed there is nothing in the record to indicate that IOS maintained an office in the United States or otherwise did business here. In fact, IOS had entered into a consent order in 1967 with the SEC pursuant to which it agreed not to conduct business here (see 192A-97-192A-98).

Plaintiff also attempts to confuse the record, when, in the midst of a list of allegedly "significant" facts, he states at p. 51 of his brief citing no support whatever -- that "[t]he plaintiff and other Americans made their purchases of IOS stock [in the United States]". Yet the District Court made no such finding, and in fact IOS and other defendants had shown below that the sale to plaintiff was made and closed outside the United States, to conform to the requirements of the 1967

* Plaintiff cites "73PA", but apparently intended "73A".

order of the S.E.C. (A79A; 192A-107). Indeed, plaintiff virtually concedes this point elsewhere in his brief in this Court, acknowledging that Bersch's purchase "was made on September 24 as part of the Public Offering" (PB, pp. 2-3) -- which closed in Europe.

ARGUMENT

Replying to Plaintiff's Brief Re IOS'

POINT I

PLAINTIFF HAS FAILED TO DEMONSTRATE THAT THE LEASCO OR SCHOENBAUM DECISIONS SUPPORT THE EXERCISE OF JURISDICTION HEREIN

IOS' main brief herein set forth a detailed legal and factual demonstration that the decision of the District Court sustaining jurisdiction over this action cannot be reconciled with the decisions of this Court in Leasco Data Processing Corp. v. Maxwell, 468 F.2d 1326 (2d Cir. 1972) ("Leasco"), and Schoenbaum v. Firstbrook, 405 F.2d 200, rev'd in part on other grounds, 405 F.2d 215 (2d Cir. 1968) (en banc), cert. denied sub nom. Manley v. Schoenbaum, 395 U.S. 906 (1969) ("Schoenbaum"). In particular IOS had previously shown that the District Court misread Leasco by ignoring the Leasco Court's careful analysis of Congressional intent which led to the

holding that fraudulent conduct in this country is a prerequisite to the assertion of jurisdiction under § 10(b) of the Securities Exchange Act (IOS Main Brief, pp. 25-45). IOS had also shown that Schoenbaum was inapplicable here because IOS stock was never listed on an American exchange nor traded in American markets.

In summary, IOS had shown that, taken together, Leasco and Schoenbaum, hold:

(a) jurisdiction cannot be exercised under § 10(b) of the Exchange Act over a foreign securities transaction unless it can be determined that Congress intended to reach the transaction under § 10(b);

(b) Congress did intend to reach transactions in a security listed on an American securities exchange, even if the transaction occurred in another country, at least to the extent the transaction injured American investors;

(c) on the other hand, in a non-Schoenbaum case (i.e., one involving a foreign transaction in a security not listed on an American exchange -- such as the stock of IOS),

Congress intended § 10(b) to apply only if there was "fraud practiced here" or at least some other serious misconduct directly connected with the fraud was committed in the United States, to the extent it injured American investors.

As applied to the instant case, IOS demonstrated that there was no proper basis for jurisdiction, since it is undisputed that IOS stock was never listed or traded in American markets, and the District Court found no misrepresentations made here or other fraudulent conduct committed here.

Plaintiff's brief attempts to state the applicable law in completely different terms. Thus, as appears most clearly from his point headings, he argues in substance that "the District Court has subject matter jurisdiction under established principles of international law" (PB, Point I.A.) (emphasis added), and that application of these principles in the instant case is not "limited" by Congressional intent (PB, Point I.B.).

In presenting his argument in this manner, plaintiff stands Leasco on its head. It is simply too clear for debate that the analysis employed in Leasco treats Congressional intent as the controlling consideration in deciding whether extrater-

ritorial transactions are within the reach of §10(b). "International law" cannot confer jurisdiction on the federal courts; as the Leasco Court recognized, "international law" is relevant only as setting limits on Congress' authority to confer on our courts jurisdiction over extraterritorial transactions (468 F.2d at 1334).

It is obvious that plaintiff tries to make "international law" controlling, rather than Congressional intent, because the District Court based its jurisdictional holding on so-called "significant conduct", a term employed by the Leasco Court in its discussion of "international law". Plaintiff's use of the terminology of "international law" is thus an attempt to establish that the District Court's analysis is consistent with Leasco's; indeed plaintiff makes the completely inaccurate statement that Leasco held "that 'significant conduct within the territory' is sufficient to confer subject matter jurisdiction" (PB, p. 33) (emphasis added), although Leasco clearly held no such thing (see IOS Main Brief, pp. 30, 33).*

* In support of the claim that Leasco deemed "significant conduct" sufficient, plaintiff quotes from Leasco but strikingly omits reference to a footnote of this Court which clearly indicates that by "significant conduct", even in the context of international law, this Court meant conduct involving the making of a misrepresentation. See 368 F.2d at 1334 fn. 3; contrast PB, p. 33 fn. Plaintiff's omission is all the more striking since IOS' Main Brief specifically called his attention, and that of the Court, to the footnote in question (IOS Main Brief, p. 33 & fn.).

A. The "Subjective Territorial Principle"

Thus, in plaintiff's discussion of the so-called "subjective territorial principle" -- i.e., of whether the conduct shown to actually have occurred in this country was sufficient to establish jurisdiction (PB, pp. 31-56) -- his brief does not so much as acknowledge the repeated statements in Leasco that the making of misrepresentations here -- and not merely so-called "significant conduct" -- is a prerequisite to the exercise of jurisdiction over a foreign transaction in a security not listed or traded in American markets. See, e.g., 368 F.2d at 1334, 1336, 1337. Nor does plaintiff even attempt to rebut the powerful considerations of law and policy, as set forth in IOS' Main Brief, which support that conclusion, including: (a) the initial presumption against assuming jurisdiction over a foreign transaction, which Congress must be deemed to respect as a matter of comity; (b) the fact that § 10(b) is an anti-fraud statute, so that this presumption is not overcome unless there has been fraud practiced here; (c) the desirability of a clear-cut jurisdictional standard to guide the district courts in a complex international context; (d) the undesirability of leaving the district courts at large with only the vague standard of "significant conduct" to guide them; and (e) the danger of conflict with the laws and legal systems of friendly foreign countries if too expansive a jurisdictional standard is adopted.

Instead of confronting IOS' position head on, plaintiff merely sets forth in his brief, as the District Court did in its opinion, a catalog of miscellaneous and completely innocent meetings and other conduct in the United States -- meetings and conduct which were largely of a preliminary and exploratory nature, and which in any event involved no contact by defendants with plaintiff or any member of his alleged class. Moreover, like the District Court, plaintiff asserts that this conduct supplies a basis for jurisdiction because in some undefined way it constituted "significant conduct."

Like the District Court, plaintiff gives no indication of what makes these meetings "significant" from the standpoint of subject matter jurisdiction in a securities fraud action, other than to echo the District Court's plainly erroneous argument that under Leasco, domestic conduct -- even though totally innocuous and in no sense wrongful -- is a basis for jurisdiction if it was an "'essential link' in the challenged transaction" (PB, pp. 51) -- an argument which IOS has already shown rests on a basic misreading of the Leasco decision (IOS Main Brief, pp. 43-45).

Unlike the District Court, however, plaintiff does not straightforwardly rest his argument on the proposition that conduct may be "significant" without being in

any respect fraudulent or wrongful. Thus, notwithstanding that the District Court did not find any wrongful conduct -- and notwithstanding that IOS has made a detailed demonstration that the domestic conduct relied on by the District Court in fact involved nothing wrongful (see IOS Main Brief, pp. 34-40) -- plaintiff now seeks to impart the impression that the conduct was wrongful, by carefully calculated over-statements and misstatements of what the underlying record in this case actually shows. Indeed, even in purportedly "summarizing" the District Court's opinion plaintiff takes liberties with the facts, stating, for example, that the District Court found that "[p]ertinent parts of the prospectus were drafted in New York" (PB, p. 21), when the Court below actually stated only what the record in fact shows -- i.e., that "the drafting of the final prospectus" was done in Europe (267A), and that only a sticker was drafted here to disclose an S.E.C. investigation (265A-66A).*

Similarly, plaintiff twice quotes lengthy excerpts from a report prepared by Price, Waterhouse & Co., Drexel's auditing consultants, questioning certain of IOS' business and financial practices and evaluating Arthur Andersen's work

* Moreover, plaintiff's use of the word "pertinent" is obviously calculated to suggest that the substance of this sticker is "pertinent" to the issues raised by the complaint. In fact, however, the matter disclosed in the sticker is not alleged by plaintiff to have been in any respect untrue or misleading.

as IOS' auditors (PB, pp. 19-20, 46-47), and refers no fewer than three times to a "ten-hour meeting" at which the report was discussed (PB, p. 19, 46, 55-56). But he never even mentions that the record shows that Price, Waterhouse "felt they got satisfactory answers" to the questions (A208A-93), and indeed that Drexel's counsel testified in this action that:

> Price Waterhouse, in the final memorandum or letter [to Drexel], indicated quite clearly they found nothing which they felt should prevent Drexel from relying on the work that had been done by Arthur Andersen.
>
> -- 223A-6

Unable to establish a single instance of fraudulent conduct in this country -- as Leasco says is required by the Exchange Act -- plaintiff further attempts to sustain the significant conduct" theory by citing cases which he claims establish a general rule that "acts in themselves legal lose that character when they become part of an unlawful scheme (PB, pp. 53-55). However, aside from the fact that plaintiff never demonstrates that there was an "unlawful scheme" here, the only authorities he cites in his discussion on this point are cases not cited by the District Court, and which arose not under § 10(b) or even under the Exchange Act, but under different statutes governed by wholly different jurisdictional standards. Thus, for example, plaintiff places heavy reliance on

the Steele v. Bulova Watch Co. decision, 344 U.S. 280 (1952), although there the Supreme Court upheld jurisdiction over an action under the Lanham Act in specific reliance on what it called "that Act's sweeping reach into 'all commerce which may lawfully be regulated by Congress'" (344 U.S. at 285). Plaintiff does not deign to explain how this holding supports the District Court's decision that there is jurisdiction here under § 10(b) of the Exchange Act, when the Leasco Court specifically stated that "the language of § 10(b) . . . is much too inconclusive to lead us to believe that Congress meant to impose rules governing conduct throughout the world in every instance where an American company bought or sold a security" (468 F.2d at 1334). See also Scherk v. Alberto-Culver Co., 417 U.S. 506, 517 n.11 (1974); Investment Properties International, Ltd. v. I.O.S., Ltd., [1970-71 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,011, at 90,735 (S.D.N.Y.), aff'd without opinion (unreported 2d Cir. 1971).

Certain antitrust cases which are also cited by plaintiff (PB, pp. 53-54) likewise do not support the proposition that the District Court correctly applied the Leasco and Schoenbaum decisions. Indeed these cited cases have nothing to do with the question of jurisdiction over extraterritorial transactions, even under the antitrust laws. Rather, the broad language which plaintiff extracts from them

merely restates the hornbook proposition that, under the anti-trust laws, an agreement among defendants to act concertedly may render conduct unlawful which would be lawful if engaged in by defendants individually.

In sum, it is apparent that plaintiff has no valid way of defending the District Court's purported application of the so-called "subjective territorial principle."

B. The "Objective Territorial Principle"

It is therefore no surprise that plaintiff has apparently placed his major reliance on this appeal on the so-called "objective territorial principle", which plaintiff asserts was applied in the Schoenbaum case. Plaintiff thus argues at length that there is subject matter jurisdiction here, not necessarily because of any acts committed in this country, but because of the alleged "detrimental effects" in this country of extraterritorial conduct (PB, pp. 56-74). In this context as well, however, plaintiff relies on arguments and authorities which are not only devoid of legal merit but were either not presented to the District Court or were given little weight in that Court's opinion.

Plaintiff's argument on the so-called "objective territorial principle" is based on the proposition that

Schoenbaum accepted the broad "principle" that any domestic impact stemming from a foreign securities transaction provides a basis for subject matter jurisdiction. But this proposition simply does not square with the facts that: (a) Schoenbaum was specifically and carefully limited to cases where the security involved in the challenged transactions was listed on an American exchange -- which IOS stock never was, and (b) Leasco strongly suggests that Schoenbaum should not be extended to cases where the domestic impact is on a stock other than that involved in the challenged transactions (see 468 F.2d at 1334).

Notwithstanding the foregoing, plaintiff has further argued that the "objective territorial principle" is satisfied here, because (a) "the United States' [securities] market image was tarnished by the IOS offering" (PB, p. 61; see also pp. 61-64); and (b) redemptions by the IOS-related mutual funds in consequence of "the collapse of IOS" caused adverse effects on the American securities markets (PB, pp. 64-70). In sum, plaintiff argues that general "market effects", allegedly attributable to the 1969 offerings, are a sufficient basis for subject matter jurisdiction over claims by purchasers in the offerings.

Neither the applicable law nor the facts support these arguments. Thus as was noted above, Leasco explicitly

expressed

> most serious doubt whether, despite United States v. Aluminum Co. of America, [citation omitted] and Schoenbaum, § 10(b) would be applicable simply because of the adverse effect of the fraudulently induced purchases in England of securities of an English corporation, not traded in an organized American securities market, upon an American corporation whose stock is listed on the New York Stock Exchange and its shareholders....
>
> -- 468 F.2d at 1334

Thus in Leasco this Court has indicated that a direct and substantial impact on a specific American corporation would not be a sufficient basis for jurisdiction in a context similar to that of the instant case. How then can remote and indirect impact based on mere claims that the IOS offerings "tarnished" the American market, or that it generally resulted in market instability, sufficiently establish jurisdiction?

Moreover, as a factual matter, it is noteworthy that the District Court here gave only limited credence to plaintiff's "market effects" arguments (perhaps in recognition of the fact, as just demonstrated, that the Leasco Court indicates it would have rejected them), noting at one point that "proof of a clear correlation between the failure of the IOS offering and the [alleged adverse domestic effects] is difficult to document" (269A). Additionally, although the District Court went

on to state that "some credence must be given to the general proposition" underlying plaintiff's contentions concerning market effects (269A), the Court later stated that "the impact on the American securities market of the IOS offering was in fact less than direct" and that there was an "absence of clearly provable or probable impact" (274A).*

In giving even limited credence to plaintiff's "market effects" argument, the District Court was actually very generous, because as a factual matter there is absolutely nothing of substance in the record below to support the proposition offered by plaintiff that the IOS offerings -- or more precisely the alleged fraud in connection therewith -- actually produced the adverse domestic effects alleged by plaintiff. To begin with, it is clear that the offerings themselves were an unprecedented success: in total 11,000,000 shares of IOS stock were sold. Given that circumstance alone, it is difficult to understand plaintiff's repeated references to an alleged "collapse" or "failure" of the "offerings" -- references which were adopted by the District Court (269A). Clearly, if there were any meaningful market effects in the United States, as alleged by plaintiff (which as already noted is highly questionable), they were

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* This conclusion is substantiated by a major SEC report to Congress in 1971 which concluded that the sales by IOS-related mutual funds had no "significant direct effect on general market stability". Institutional Investor Study Report, H.R. Doc. No. 64, 92nd Cong., 1st Sess., Vol. 3, pt. 3, p. 947 (1971).

not the result of any collapse of the offerings -- an event which simply did not occur -- but of the ultimate collapse of IOS itself. Moreover, the collapse of IOS did not even begin until perhaps April of 1970, more than six months after the 1969 offerings were consummated. Thus, any effects traceable to those events -- or to the events following thereafter, when IOS fell into the hands of Robert L. Vesco and his associates -- are completely irrelevant to the issue of jurisdiction over the 1969 offerings.

There is nothing in the affidavit of Morris Mendelson (71A-1-71A-7) -- so heavily relied upon by plaintiff -- which contradicts the foregoing. Indeed, as a close reading of that document discloses, it recognizes that the alleged loss of investor confidence and the increased redemptions which it describes related not to the 1969 offerings of IOS' stock but rather to IOS' collapse commencing many months later. However, the Mendelson Affidavit is carefully worded to leave the impression that the alleged market effects were indirect results of the earlier offerings, by the use of words which suggest or intimate that the IOS collapse was the result of the IOS offerings. However, the illogic of this argument is apparent once it is clearly stated: a company does not collapse because it makes

a highly successful offering of its shares.*

C. The "Nationality Principle"

Plaintiff makes a final effort to avoid confronting the clear inconsistencies between the decision below and this Court's decisions in Leasco and Schoenbaum by arguing that there is jurisdiction herein under the so-called "nationality principle" (PB, pp. 71-74). However, as the District Court correctly noted, this "principle" "carries less weight than the two approaches already described" (263A n.8). Indeed, even plaintiff concedes that "the courts have not as yet sustained jurisdiction solely [footnote omitted] on this ground" (PB, p. 73).

Moreover, so far as IOS is concerned, the nationality principle is completely irrelevant, since IOS was a Canadian corporation, which not only had its executive offices and sales offices exclusively in foreign countries but was actually subject to an order of the S.E.C. forbidding it from doing business

* At one point in the Mendelson Affidavit as quoted by plaintiff (PB p. 63), it is stated that: "The false and misleading prospectus issued in connection with the Public Offering impaired investors' confidence and trust and contributed to a steep decline in the purchase of United States securities by foreigners". However, the cause and effect aspect of this statement is wholly unsupported by anything in Mr. Mendelson's affidavit or otherwise. There is not one affidavit of a single foreigner who purportedly refused to purchase American securities because IOS had allegedly committed a fraud. Nor is there anything else which constitutes evidence to support Mr. Mendelson's connective conclusion.

in the United States (192A-97-192A-99). Plaintiff's suggestion that his claims against IOS are within the subject matter jurisdiction of the federal courts because of IOS' "American image" (PB, p. 74) or because of the so-called "American character of the public offering" (PB, pp. 27-28) is without any supporting authority, and would, if accepted, make the "nationality principle" into a hopelessly vague and unworkable doctrine.*

In sum, plaintiff's brief demonstrates only that the District Court's decision cannot be reconciled with the principles and analytic approach of Schoenbaum and Leasco.

Replying to Plaintiff's Brief Re IOS'

POINT II

PLAINTIFF HAS FAILED TO REBUT IOS' DEMONSTRATION THAT THE THREE OFFERINGS CANNOT BE "INTEGRATED" FOR PURPOSES OF SUBJECT MATTER JURISDICTION

The District Court's Opinion states that the basis of its finding of subject matter jurisdiction was its "integration" holding -- i.e., its decision that the three offerings were so "integrated" as to make it appropriate to have "their prime movers collectively considered for purposes of subject

* It is inherently far more plausible to argue that the offering had a distinctly non-American and "international character" since it was made in numerous countries excluding the United States pursuant to prospectuses printed in five languages and underwritten by international firms.

matter jurisdiction" (259A). As IOS had shown in its original brief (IOS Main Brief, pp. 46-47), the "integration" holding was indeed central to the decision below, since in the absence of such "integration" there would be no purchaser who could satisfy the two-fold jurisdictional test applied by the District Court, which requires (a) injury to an American investor and (b) "significant conduct" in the United States.* Thus, the District Court found "significant domestic conduct" only in connection with the Drexel offering -- in which there were no American purchasers -- and American investors only in the IOB offering -- in which no domestic conduct, significant or otherwise, was found. No domestic conduct of any significance was found with respect to the Crang offering.

Plaintiff's brief in this Court attempts to minimize and indeed distort the relevance of the integration issue by giving it only cursory treatment, and suggesting that it is relevant not to his 10b-5 claim, but to the much less pivotal question of whether these offerings were required to be registered under the Securities Act (PB, pp. 23-27).** Thus plaintiff

* Of course as already noted the District Court's concept of "significant conduct" for jurisdictional purposes does not conform to the holdings of Leasco and other cases cited by defendants (IOS Main Brief, pp. 27-35; see also pp. 10-13, supra).

** Any possible non-registration claim arising from the 1969 offerings was, of course, clearly time-barred when this 1971 action was instituted. See Securities Act §13; see also IOS Main Brief, pp. 11-12 fn.

completely fails even to acknowledge IOS' demonstration that the "integration" decision was the foundation of the District Court's jurisdictional holding, and that, as the District Court itself suggests, if this Court were to reverse the integration decision, the finding of jurisdiction under §10(b) would also have to be reversed.

Moreover, plaintiff has not responded to IOS' argument that, even if the three offerings "can be viewed" as one, two or three offerings, depending on which aspects of the transactions one focusses on -- as the District Court stated -- they should be viewed as three separate offerings for subject matter jurisdiction purposes because those aspects of the offerings which are inherently and undeniably relevant to subject matter jurisdiction all point to the conclusion that there is no basis for "integration" (IOS Main Brief, pp. 47-49).

For example, plaintiff makes no attempt to rebut IOS' showing that the proper jurisdictional criteria for deciding whether separate offerings can be "integrated" for jurisdictional purposes include such matters as:

> Whether the offerings were all directed to the same kinds of investors in the same countries -- since the jurisdiction of the court is allegedly based on sales pursuant to misleading prospectuses;

Whether the prospectuses used in the offerings were prepared by a single underwriting group -- since the jurisdiction of the court is allegedly based on the falsity of the prospectuses;

Whether the prospectuses were prepared under a single legal system -- since the applicable standards of disclosure are a major factor in deciding the issue of falsity in a case chiefly involving non-disclosure.*

Obviously plaintiff does not concede that these are the relevant criteria -- since every one of them, as applied to this case, indicates the impropriety of the District Court's integration holding (see IOS Main Brief, pp. 47-49).

But it is highly significant that plaintiff does not even attempt to show by what criteria the facts on which he relies are jurisdictionally significant. Indeed, instead of discussing the central question of whether any relevant jurisdictional criteria support the District Court's integration holding, plaintiff attempts to sustain that finding chiefly by the conclusory claim that "one [of the offerings] would not have occurred without the other. The primary and secondary

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* Plaintiff's assertion that "the prospectuses used were in in all material respects, identical "(PB, p. 24) is simply contrary to fact, if for no other reason than that the Crang prospectus was prepared under the thorough supervision and control of the Canadian securities authorities.

features of the offering were necessary concomitants" (PB, p. 23). Plaintiff has never presented any evidence to support this assertion as a matter of fact,* and it is completely illogical if considered as an a priori proposition. Thus although plaintiff makes the unsupported assertion that "without a secondary [offering] which allows management to realize on their [sic] investment, there would have been no incentive for the primary offering" (PB, p. 23), it is obvious that the primary offering had the independent and adequate purpose of raising more than $50,000,000 for IOS.

For the rest, plaintiff merely points to respects in which the offerings can be regarded as an integrated transaction but, as noted above, without indicating why these facts are relevant to the jurisdictional issue. It is submitted that the various facts cited by plaintiff are irrelevant to the establishment of jurisdiction in the first instance -- whatever their possible relevance to the clearly distinct question of whether defendants in a case within a court's jurisdiction can be treated as joint tortfeasors. See S.E.C. v. National

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* Indeed the District Court stated that the "relatedness of purpose" of the three offerings was "difficult to document" (259A) -- clearly suggesting that in its view plaintiff had not documented such "relatedness." As is pointed out in IOS' Main Brief, this circumstance in and of itself indicates that the "integration" finding is not supported by adequate, relevant evidence -- evidence all the more important because it relates to the fundamental issue of subject matter jurisdiction (IOS Main Brief, p. 49 fn).

Bankers Life Insurance Co., 324 F.Supp. 189, 194, 197 (N.D. Tex.), aff'd, 448 F.2d 652 (5th Cir. 1971), discussed in IOS' Main Brief, pp. 50-51. As the Bankers Life case clearly shows, "integration" for jurisdictional purposes under the circumstances presented in this case is improper, and the District Court's contrary decision should be reversed.

Replying to Plaintiff's Brief Re IOS'

POINT III

PLAINTIFF HAS FAILED TO ESTABLISH ANY BASIS FOR FEDERAL JURISDICTION OVER THE CLAIMS OF FOREIGN PURCHASERS WHO BOUGHT THE STOCK OF IOS, A FOREIGN ISSUER, IN FOREIGN COUNTRIES

In practical terms, a distinct and very substantial issue raised by this appeal is whether -- even if there is jurisdiction over the claims asserted on behalf of Americans in this action -- the District Court properly asserted jurisdiction over the claims of tens of thousands of foreign citizens whose IOS stock was purchased in foreign countries, pursuant to prospectuses which in many cases were printed in foreign languages. Whatever the precise number of such purchasers may have been, there is no bona fide dispute that the overwhelming majority of the purchasers in the three

offerings fit this description.*

There is also no dispute that a determination that the District Court properly sustained jurisdiction over plaintiff Bersch's claim would not ipso facto mean that there is jurisdiction over the claims of foreign purchasers. Even plaintiff concedes the applicability of the fundamental proposition that every plaintiff in a "spurious" class action must show that his claim is individually and independently within the court's jurisdiction (PB, pp. 86-87). See Zahn v. International Paper Co., 414 U.S. 291 (1973); IOS Main Brief, pp. 52-59. It is submitted that it is equally clear that there is in fact no basis for jurisdiction over the claims of such foreign purchasers in this case.

Plaintiff has not even attempted to distinguish the cases cited by IOS which indicate that foreign purchasers of the securities of a foreign issuer not listed or traded

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* As shown earlier, plaintiff's assertion to this Court that 13.7% of the shares were bought by American investors is completely contrary to the very record items cited in alleged support of it. In actuality, after eliminating IOS directors' shares, less than 1.3% of the shares were purchased by Americans and less than .013% by American residents (see pp. 2-6, supra). Moreover, even if plaintiff's figures were correct, the vast majority of plaintiff's alleged class members would still be foreigners, since plaintiff's (erroneous) figures relate not to the number of purchasers but to the number of shares purchased. While, as noted above, plaintiff has attempted to suggest to this Court that the total number of purchasers was much less than originally stated in his complaint, he has failed to indicate the basis for this new figure.

in the United States, whose purchases were made in foreign countries, cannot sue in the federal courts under § 10(b). See, e.g., Finch v. Marathon Securities Corp., 316 F. Supp. 1345 (S.D.N.Y. 1970); Investment Properties International, Ltd. v. I.O.S., Ltd., supra; Sinva v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 48 F.R.D. 385, 386 (S.D.N.Y. 1969). Nor does plaintiff acknowledge or discuss the clear implication in Leasco itself that there is no jurisdiction over such claims (368 F.2d at 1332, 1337-38; see IOS Main Brief, p. 54 & fn.).

Instead plaintiff now suggests that there is subject matter jurisdiction over such foreign claims merely because American investors may have claims arising from their (i.e., the Americans') purchases in the transactions in which foreigners also bought (PB, p. 89). However, this argument is both contrary to the purposes of the securities laws, and unsupported by relevant authority.

Thus, it is clear that the basic purpose of the American securities laws is to protect American investors. The decisions in Schoenbaum and Leasco are expressly based on findings that "extraterritorial application of the [Exchange] Act is necessary to protect American investors". Schoenbaum, 405 F.2d at 206; see also Leasco, 468 F.2d at 1336-37. Acceptance of plaintiff's argument -- in substance that foreign

purchasers can sue merely because Americans may have claims arising from the 1969 offerings -- would not advance the goal of "protecting American investors", and therefore would not be consistent with Congressional intent as construed by Leasco and Schoenbaum. Since plaintiff is of course protecting his own interests, and that of all other American purchasers, by bringing this action, it is not necessary that jurisdiction be exercised over the claims of tens of thousands of foreigners to protect him or any other American investor. In Weaver v. United California Bank (unreported N.D. Cal. 1974), the Court specifically found no jurisdiction over the claims of foreign members of an alleged class, noting that "extraterritorial application of the securities laws would not protect domestic investors and domestic markets, and would thus be unwarranted" (emphasis added).*

Furthermore plaintiff has not cited this Court to any other relevant authority in which such suits were allowed. In particular, his citation of Kohn v. American Metal Climax, Inc., 458 F.2d 255 (3d Cir.), cert. denied, 409 U.S. 874 (1972), is completely misleading, since plaintiff fails to advise the Court (a) that the stock of the Zambian corporation whose share-

* A true copy of the memorandum decision in Weaver was presented to the District Court as Exhibit A to the affidavit of Leonard M. Marks, sworn to July 9, 1974 (Record Item 137). The passage discussed above is at pp. 3-4 of the memorandum decision.

holders comprised the plaintiff class was listed for trading on the New York Stock Exchange, (b) that the corporation had 40,000 individual shareholders in the United States who owned 37.7% of the corporation's shares, (c) that an additional 42.3% of the issued shares were owned by an American corporation, and (d) that the shares of the parent company were also listed on the New York Stock Exchange. (These facts are set forth in the District Court's decision in Kohn, 322 F. Supp. 1331, 1336 (E.D. Pa. 1970)). Manifestly the fact that some incidental benefit was conferred on a small number of foreign stockholders of an American listed company in that case is no authority for the assertion of jurisdiction in a case where virtually all of the purchasers were foreigners, who bought the stock of a foreign issuer neither listed nor traded in the United States.

Other cases cited by plaintiff are equally distinguishable. Thus, S.E.C. v. United Financial Group, 474 F.2d 354 (9th Cir. 1973), Wandschneider v. Industrial Incomes Inc. of North America, [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,422 (S.D.N.Y. 1972) and SEC v. Gulf Intercontinental Finance Corp., 223 F. Supp. 987 (S.D. Fla. 1963), all involved securities issued by American issuers or by companies controlled from the United States (see 474 F.2d at 356; [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,422 at

92,056-57, 92,065; 223 F. Supp. at 995) and extensive actual fraudulent misconduct in this country (see 474 F.2d at 356, 357; [1971-72 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,422, at 92,057, 92,059-60, 92,064-65; 223 F. Supp. at 990-95), facts which as noted above are completely lacking in this case (see also IOS Main Brief, pp. 34-40.)*

It is additionally significant that neither S.E.C. v. Gulf Intercontinental Finance Corp. nor S.E.C. v. United Financial Group, was a suit for damages, but rather each was a government action in which injunctive relief was sought in the interests of vindicating or protecting the American investors or the American market place. Clearly the jurisdictional considerations in such cases are different from private damage actions by foreigners who had no contacts with the United States (cf. S.E.C. v. Texas Gulf Sulphur Co., 401 F.2d 833, 863 (Waterman, J.), 866-68 (Friendly, J. concurring) (2d Cir. 1968), cert. denied sub nom. Kline v. S.E.C., 394 U.S. 976 (1968), noting the general principle that different standards are applicable to damage

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* With respect to the Gulf Intercontinental case, it should also be noted that Judge Frankel has correctly observed that "some language in that opinion appears to contradict decisions in this Circuit" -- citing Finch v. Marathon Securities Corp., supra and Schoenbaum. Investment Properties International, Ltd. v. I.O.S., Ltd., supra, [1970-71 Transfer Binder] CCH Fed. Sec. L. Rep. ¶ 93,011, at 90,737.

actions than may be appropriate in an S.E.C. enforcement action).

It is apparent from the foregoing, that whatever the rights of American residents or American citizens may be to institute suits in this country with respect to extraterritorial securities transactions, there is no comparable right in favor of foreigners. Indeed, as noted the cases have repeatedly stated that foreigners in contexts similar to the instant case cannot sue in United States courts under these circumstances, and contrary to plaintiff's assertions, "foreign plaintiffs would [not] have an independent cause of action" (PB, p. 87) under the American securities laws. Therefore under the principle most recently employed by the Supreme Court in Zahn v. International Paper Co., supra, whereby each member of a spurious class must show that there is an independent basis for federal jurisdiction over his claims, the complaint herein must be dismissed at least as to the foreign purchasers in the 1969 offerings (see IOS Main Brief, pp. 52-59).

Conclusion

The decision of the District Court should be reversed, and the complaint dismissed, in its entirety or, alternatively,

as to the non-American residents, for want of subject matter jurisdiction.

Dated: New York, New York
March 3, 1975

Respectfully submitted,

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Michael W. Schwartz
Of Counsel

Computation of Purchased Shares Reflected in Defendants-Appellants' Appendix, Pages 227A-228A, 229A-232A, and Plaintiff-Appellee's Appendix, Pages 131PA-160PA

Pages 227A-228A

200 <+
1000 <+
1426 <+
1000 <+
1000 <+
1400 <+
500 <+
31000 <+
1000 <+

Pages 229A-232A

1000 <+
1000 <+
1000 <+
1000 <+
600 <+
1000 <+
600 <+
140 <+
400 <+
91 <+
159 <+
270 <+
150 <+

Pages 131PA-160PA

600 <+
800 <+
600 <+
800 <+
1000 <+
150 <+
1000 <+
1000 <+
1000 <+
<+
1000 <+
600 <+
600 <+
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95 <+
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34 <+

120 <+
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38 <+
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17 <+
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139 <+
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132 <+
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90 <+
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785 <+
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220 <+
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270 <+
201 <+
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226 <+
200 <+
150 <+
175 <+
600 <+
800 <+
160 <+
1000 <+
1000 <+
234 <+
200 <+
300 <+
170 <+
70 <+
115 <+
104 <+
600 <+
324 <+
902 <+
245 <+
1000 <+

147 <+
200 <+
290 <+
325 <+
662895 <+

Grand Total

844803 <+

EXHIBIT A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

HOWARD BERSCH,

Plaintiff-Appellee,

against

ARTHUR ANDERSEN & CO., I.O.S., LTD., and BERNARD CORNFELD,

Defendants-Appellants,

and

DREXEL FIRESTONE, INC., ET AL.,

Defendants.

State of New York,
County of New York,
City of New York—ss.:

DAVID F. WILSON, being duly sworn, deposes and says that he is over the age of 18 years. That on the 3rd day of March, 1975, he served two copies of Reply Brief of Defendant-Appellant I.O.S., Ltd. on See attached list, the attorneys for See attached list by delivering to and leaving same with a proper person in charge of their office at See attached list in the Borough of Manhattan, City of New York, between the usual business hours of said day.

David F. Wilson

Sworn to before me this
3rd day of March, 1975.

Courtney J. Brown

COURTNEY J. BROWN
Notary Public, State of New York
No. 31-5472020
Qualified in New York County
Commission Expires March 30, 1976

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